

An exempt employees' pension trust does not incur 'business lease indebtedness' under section 514(c) of the Code when it purchases land free of mortgage indebtedness and executes a 40-year lease to an unrelated partnership that mortgages its leasehold interest.

Advice has been requested whether an exempt employees' pension trust incurred 'business lease indebtedness' within the meaning of section 514(c) of the Internal Revenue Code of 1954 (prior to its amendment by the Tax Reform Act of 1969, Public Law 91-172 (C.B. 1969-3, 10) under the circumstances described below.

An exempt employees' pension trust purchased a parcel of land, paying the purchase price entirely from its own assets. The trust executed a ground lease for a term of 40 years to an unrelated partnership that therein agreed to develop the land by the demolition of existing structures and the construction of a general purpose office building and parking facility.

The leasehold agreement provided for rentals that were reasonably commensurate with the benefits and privileges made available to the lessee-partnership thereunder, including authorization on the part of the lessee-partnership to mortgage the leasehold interest thereby created as security for construction financing loans and a commitment on the part of the trust to subordinate its fee interest to the leasehold mortgages.

It also provided that the lessee-partnership was not authorized to act on behalf of the trust as a joint venturer in relation to any activity affecting the agreement. The agreement provided that the trust would incur no direct or indirect personal obligation on any mortgage notes in connection with such financing but would nonetheless have the right to cure any default of the lessee-partnership. It further provided that the lessee-partnership would continuously maintain all the leasehold improvements in good repair and return the premises free and clear of all liens at the expiration of the leasehold term. The lessee was also given a continuing option to purchase the trust's entire interest in the property at any time prior to its expiration. All of the financing arrangements initially contemplated were thereafter duly carried out.

Prior to its amendment by the Tax Reform Act of 1969, section 514(c)(1) of the Code defined 'business lease indebtedness' as the unpaid amount of an indebtedness, with respect to any real property leased for a term of more than five years, (a) incurred by the lessor in acquiring or improving such property, (b) incurred before the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement, or (c) incurred after the acquisition or improvement of such property if such indebtedness would not have been incurred but for such acquisition or improvement and the incurrence of such indebtedness was reasonably foreseeable at the

time of such acquisition or improvement.

Prior to its amendment by the Tax Reform Act of 1969, section 514(c)(2) of the Code provided that, when real property is acquired subject to a mortgage or similar lien, the amount of the indebtedness secured by such mortgage or lien shall be considered as an indebtedness of the lessor incurred in acquiring such property even though the lessor did not agree to pay such indebtedness.

Section 1.514(c)-1(a) of the Income Tax Regulations limits the application of the term 'business lease indebtedness' to an indebtedness incurred by a lessor tax exempt organization.

In this case, it was the partnership and not the trust that incurred the indebtedness. Furthermore, the mortgage was placed on the land subsequent to the acquisition thereof by the trust.

The foregoing facts show that no obligation was incurred in purchasing the land and that the land was not acquired by the trust subject to a mortgage. It therefore follows that the sections of the Code and regulations referred to above do not apply to this situation.

It is held, under the facts in this case, that the trust did not incur any 'business lease indebtedness' within the meaning of section 514(c) of the Code.

This ruling does not deal with the different situation that would exist if the trust should hereafter step into the lessee's shoes under the construction mortgage or otherwise acquire a direct interest in the leasehold improvements while they remain subject to the lien of that mortgage.